

EARNINGS SHARING OPTIONS FOR
THE SOCIAL SECURITY SYSTEM

The Congress of the United States
Congressional Budget Office





PREFACE

A number of proposals have been made that would combine the earnings of husbands and wives and divide them equally for the purpose of calculating Social Security benefits--"earnings sharing." The Social Security Amendments of 1983 directed the Secretary of Health and Human Services (HHS) to prepare a report on earnings sharing, which was submitted last year. The Amendments also directed the Congressional Budget Office (CBO) to examine the methodologies, recommendations, and analyses used in the HHS report. This report to the Senate Committee on Finance and to the House Committee on Ways and Means responds to this requirement. In accordance with CBO's mandate to provide objective and impartial analysis, it contains no recommendations.

Ralph E. Smith and Richard A. Kasten of CBO's Human Resources and Community Development Division, and Paul R. Cullinan of the Budget Analysis Division, conducted this study under the general supervision of Nancy M. Gordon and Martin D. Levine. Many people provided valuable comments, including Dorothy Amey, David C. Lindeman, Alicia H. Munnell, Frank J. Sammartino, Neil M. Singer, Lawrence H. Thompson, Sheila R. Zedlewski, and staff of the Social Security Administration in the Office of Legislative and Regulatory Policy and in the Office of the Actuary. The manuscript was edited by Francis S. Pierce. Ronald Moore typed the several drafts, provided editorial assistance in the draft stages, and prepared the report for publication.

Rudolph G. Penner
Director

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SUMMARY

Almost 37 million people now receive Social Security cash benefits. Many of them receive their benefits as spouses, ex-spouses, or survivors of workers covered by Social Security. For example, a wife can receive a spousal benefit equal to up to 50 percent of her husband's basic benefit; if she is a widow, she can receive up to 100 percent of the amount to which he would have been entitled. In general, the total amount that can be received by someone who is eligible for benefits both as a worker and as an "auxiliary" of a worker equals the higher of the two amounts. 1/

This treatment of couples in which both spouses have worked and paid Social Security payroll taxes for substantial portions of their lives has come under criticism as more married women pursue careers. Because married women can receive benefits as spouses based on their husbands' earnings, they often receive little, if any, additional retirement benefits from their own (and their employers') Social Security taxes, compared with the amounts they would receive based on their husbands' earnings. Two-earner couples generally receive lower total retirement benefits than one-earner couples with the same total covered earnings and similar payroll tax contributions, because a spouse's benefit is provided for spouses who had little or no attachment to the paid labor force. Moreover, survivors of two-earner couples generally receive less than survivors of one-earner couples with the same total covered earnings.

Concern has also been raised about the adequacy of benefits for many elderly unmarried women. Elderly women are more likely to rely on Social Security benefits for the majority of their incomes than are married couples and elderly men. In 1984, 2.0 million of the 3.3 million poor Social Security beneficiaries age 62 and over were unmarried women.

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1. Divorced spouses can receive benefits as if still married, if the marriages lasted at least 10 years, if they are not married at the time they become eligible for benefits, and if they meet the other eligibility requirements. All spouses, whether men or women, are eligible for auxiliary benefits; at times, for ease of exposition, explanations are in terms of wives, divorced women, or widows.



A number of proposals have been made to change the rules by which Social Security benefits are calculated. Some would credit each spouse with half of the couple's combined covered earnings for the purpose of determining Social Security benefits. This approach is referred to as "earnings sharing."

The Social Security Amendments of 1983 (Section 343) directed the Secretary of Health and Human Services (HHS) to prepare a report on earnings sharing and instructed the Congressional Budget Office (CBO) to report on "the methodologies, recommendations, and analyses used in the Secretary's report." The HHS report contains a detailed analysis of the potential effects of two specific earnings sharing plans and of several options for making the transition from the present benefit structure to one based on earnings sharing. A simulation model was used to depict the characteristics of the beneficiary population in the year 2030, thereby enabling HHS to estimate the effects on major beneficiary groups 40 years after earnings would have begun to be shared under the two earnings sharing plans it examined. Long-range costs were estimated by the Social Security Administration's Office of the Actuary. HHS also analyzed two dozen options other than earnings sharing that could be used to address one or more of the problems for which earnings sharing has been proposed. The HHS report made no recommendations. 2/

CBO has no criticism of the basic methodology used by HHS or of the way its methodology was applied. The microsimulation approach is the most appropriate method of estimating the potential effects on future beneficiaries of a major change in the Social Security system. Nonetheless, specific estimates are subject to a wide range of errors and interpretations. For example, it is impossible to predict accurately the values of the many variables, such as future economic and demographic trends, on which the estimates are based. This report by CBO, therefore, includes further analyses intended to complement those of HHS and to provide additional perspectives on its findings. For example, CBO examined several issues and options not addressed in the HHS report, including the sensitivity of some of the estimated effects of earnings sharing to alternative assumptions about women's future labor force activities and future divorce patterns.

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2. The report also discusses the potential effects of earnings sharing on the administration of the Social Security system and the concerns of various interest groups regarding the treatment of women under the present benefit structure. These aspects of the HHS report are not addressed in this report.

ISSUES

Throughout the evolution of the Social Security system, the benefit structure has maintained a number of key features and premises: that benefits should be related to covered earnings; that the benefit structure should be progressive, in the sense that the percentage of wages replaced should be higher for beneficiaries with low earnings histories than for beneficiaries with high past earnings; and that receipt of benefits should not be means-tested.

Earnings sharing proposals would maintain most of the basic features of the system. Because earnings credits accumulated by spouses during a marriage would be divided evenly between them for the purpose of computing entitlement to benefits, however, people would receive benefits based only on their own earnings records. This benefit structure would replace the current structure under which people can get workers' benefits based on their own records and can also qualify for benefits as spouses or surviving spouses based on the earnings records of their spouses or ex-spouses. The objectives of proponents include making the system, in their view, fairer in its treatment of two-earner couples and their survivors, and providing adequate benefits for divorced women, widows, and women who have taken time out of the labor force for child care.

Some opponents of earnings sharing agree with the criticisms of the current Social Security benefit structure, but are concerned that earnings sharing would be too costly or too likely to cause disruptions in the lives of recipients. Moreover, earnings sharing would be difficult to implement and would not assist beneficiaries in the near term. Others are opposed to earnings sharing because they view the current system as a superior method of providing benefits to workers and their families.

The fundamental problem in any change in the benefit structure--whether based on earnings sharing or not--is that increasing benefits for some would mean either reducing benefits for others below what they otherwise would receive or making up the difference by higher taxes. The key issues for the Congress, then, are whether it wants to make changes in the Social Security benefit structure that would raise some people's benefits, and, if so, how it wishes to pay for them. Earnings sharing need not result in net additional outlays; but if not, some beneficiaries would receive lower benefits than they are scheduled to be paid under current law.

The introduction of earnings sharing would also raise certain problems of transition. How rapidly should it be done, and how should benefits be

determined for those whose earnings records would include years both before and after the change? 3/

EARNINGS SHARING OPTIONS

Two major earnings sharing plans were examined in the HHS report--Generic Earnings Sharing and Modified Earnings Sharing. The key features of the Generic plan, once it was fully implemented, would be: 4/

- o Earnings of husbands and wives would be evenly divided during years of marriage, and benefits would be based on each person's own record;
- o A surviving spouse would be credited with the entire amount of the decedent's covered earnings for each year of marriage (with the restriction that the survivor's record each year could not include more than the maximum taxable earnings base for that year); and
- o Auxiliary benefits for spouses and for surviving spouses would be abolished.

The Modified plan is designed to help beneficiaries in certain circumstances and to avoid certain problems that might otherwise result from earnings sharing under the Generic plan. Its key features are as follows:

- o Earnings records would be combined and shared only when a couple divorced, when both spouses claimed worker benefits, or when the lesser-earning spouse claimed disability benefits. By sharing earnings then, rather than as earnings were credited, certain beneficiaries would not lose benefits relative to current

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3. The HHS report (Chapter VI) also raised a number of administrative issues concerning earnings sharing. Converting to a new system in which earnings records each year would reflect combined, rather than individual, earnings would certainly require the Social Security Administration to undertake a major change in its recordkeeping systems and would also involve additional operating costs, especially during the transition period.
 4. Other specifications for this plan include: earnings sharing would terminate on the date of a final divorce decree; each person's insured status would be based on the earnings credited to his or her record after sharing and/or inheritance; and benefits for children and the family maximum would be based on a worker's earnings records, adjusted by shared or inherited earnings.

law as they would under Generic earnings sharing; for example, if only the higher-earning spouse of a lifelong couple retired, he or she would be able to claim current law benefits until the other spouse retired.

- o Both spouses would be insured for benefits if either spouse was considered insured under current law; this would prevent a spouse who would have been eligible for worker or auxiliary benefits under current law from losing eligibility under earnings sharing.
- o The current law special minimum benefit provision would be modified by lowering the earnings level needed to qualify for a year of coverage; by adding five years of coverage that would be countable; by indexing the value of a year of coverage by a wage index, rather than by a price index; and by including years of child care as years of coverage.^{5/} These modifications would especially help beneficiaries with many years of employment and low earnings.

Each plan would be implemented prospectively--that is, earnings before 1990 would not be shared, and benefits would be based on shared earnings records of workers who become eligible only in 1995 or later. Thus, not until the middle of the next century would the majority of beneficiaries have earnings histories that reflected entire careers in which earnings records were shared during years of marriage.

As a result, moving to the new system would require special transition provisions. Otherwise, some people would incur reductions in benefits simply because their earnings records would only reflect earnings sharing for a part of their worklives. If all benefits were based on shared earnings starting only five years after implementation, large losses could occur for many beneficiaries in the early years.

HHS and CBO analyzed several sets of transition provisions that could be used to ameliorate this problem. Each would guarantee beneficiaries some or all of the benefit amount to which they would be entitled under current law, if that amount was higher than what they would receive under the earnings sharing plan. The four alternatives analyzed by CBO can be briefly characterized as follows:

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5. Up to 10 years of caring for children under age six could be included in the calculation of benefits under the special minimum provision.

- o Transition I would enable survivors and divorced spouses to continue to receive benefits based on current law, rather than on earnings sharing, if based on events that occurred before the plan went into effect.^{6/} A declining current law benefit guarantee would also be provided, although by 2030 it would have little, if any, effect on the benefits of individuals retiring then.
- o Transition II would provide a current law benefit guarantee to survivors of workers who died before 1995. A guarantee for spouses' benefits would be rapidly phased out, so it would not be available to spouses becoming eligible after 2005. Likewise, survivors' benefits would not be available for those becoming eligible after 2015.
- o Transition III contains a declining guarantee intended to provide the least losses to those with low benefits; it would also provide additional amounts to certain divorced beneficiaries.
- o Transition IV would guarantee recipients 100 percent of current law benefits for a specified period or indefinitely. The specific provisions of the "no-loser" option analyzed by CBO would guarantee couples their total combined benefits, and would guarantee others their individual benefits, under current law.

Transitions I and II were presented and analyzed in the HHS report. Transition III was subsequently suggested by the Technical Committee on Earnings Sharing, a private group that has been developing an earnings sharing plan. The HHS report analyzed a no-loser option similar to Transition IV, but with each recipient guaranteed his or her current law benefit; this would mean that many couples whose combined benefits under earnings sharing would be at least as high as under current law would nonetheless be receiving additional amounts from the guarantee.

POTENTIAL EFFECTS OF EARNINGS SHARING

How would the two earnings sharing plans affect recipients of Social Security? CBO has analyzed the Generic plan and the Modified plan in combination with various transition provisions. These illustrate the wide range of specific earnings sharing options that could be designed to change

6. Current law survivor benefits would be guaranteed to survivors of marriages that began prior to 1990 and to survivors of spouses who died before 1995. Current law spousal benefits would also be guaranteed to divorced spouses for marriages that began before 1990.

the Social Security system. Summary Table 1 highlights the effects of three of the options also examined by HHS on the average benefit levels in 2030 (expressed in 1984 dollars) for each of several types of elderly recipients.

- o Generic Earnings Sharing with Transition I (hereafter called Generic I) illustrates the effects of the Generic plan if implemented with relatively generous current law guarantees.
- o Modified Earnings Sharing with the same transition rules (Modified I) may be compared with Generic I to show the differences in effects between these two versions of earnings sharing.
- o Modified Earnings Sharing with Transition II (Modified II) may be compared with Modified I to show the importance of the transition rules.

CBO's estimates are based on the same simulation methodology and assumptions used by HHS. Minor differences between the versions of the simulation model used by CBO and HHS resulted in inconsequential differences in the estimated effects. In addition, HHS focuses on the number of recipients who would gain or lose at least 1 percent of their current law benefits in 2030, whereas the tables in the CBO report only record changes of at least 5 percent. An estimated gain or loss of only 1 percent in 2030 seems too small to be meaningful, given the uncertainty of the estimates. ^{7/}

Effects on Beneficiaries

Each of these options would move the Social Security benefit structure closer to the achievement of three key objectives of the proponents of earnings sharing. First, the combined retirement benefits of couples would be less affected by the proportion of total covered wages earned by each spouse. Consequently, the average benefit of couples in which the wives had

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7. The main differences in results involve dissimilarities in the number of beneficiaries in each group, rather than any substantial differences in estimated effects of earnings sharing. For example, HHS estimates that there would be 13.4 million elderly married couples receiving benefits, rather than 12.9 million, and that Generic I would reduce their average benefit by 0.3 percent, rather than 0.5 percent. Moreover, the tables in the CBO report show fewer winners and losers, but with larger average gains and losses. This is a direct consequence of using a 5 percent, rather than a 1 percent, change to identify winners and losers.

SUMMARY TABLE 1. AVERAGE ANNUAL SOCIAL SECURITY BENEFITS OF SELECTED ELDERLY GROUPS IN THE YEAR 2030 UNDER ILLUSTRATIVE EARNINGS SHARING OPTIONS (Numbers of beneficiaries in millions; benefits in 1984 dollars) a/

Group	Number of Beneficiaries	Benefits			
		Current Law	Generic I	Modified I	Modified II
Married Couples ^{b/}					
Total	12.9	16,670	16,590	16,960	16,900
Wives worked at least 30 yrs.	7.8	17,030	17,260	17,560	17,490
Wives worked fewer than 30 yrs.	5.1	16,100	15,540	16,040	15,970
Widows					
Total	15.3	9,190	9,230	9,270	8,140
Worked at least 30 yrs.	8.2	9,710	9,870	9,910	9,040
Worked fewer than 30 yrs.	7.1	8,600	8,490	8,530	7,090
Divorced Women with Deceased Ex-Husbands					
Total	6.4	8,240	8,490	8,600	7,700
Worked at least 30 yrs.	4.6	8,420	8,760	8,870	8,190
Worked fewer than 30 yrs.	1.8	7,780	7,750	7,880	6,410

(Continued)

- a. See the text for a description of the plans. Beneficiaries depicted in this table are age 62 or older and would comprise approximately three-quarters of all beneficiaries in the simulated population.
- b. Couples in which both spouses would receive benefits under current law and at least one spouse is age 62 or older.